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Role of the Private Sector in Developing Countries

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Following are the statement by M. Peter McPherson, Administrator of the Agency for International Development (AID), and excerpts from the statement by Robert D. Hormats, Assistant Secretary for Economic and Business Affairs, before the Subcommittee on Trade, Productivity and Economic Growth of the Joint Economic Committee, October 19, 1981.

MR. McPHERSON

I greatly appreciate this opportunity to address the subject of these hearings: "Aid and the Private Sector: Can they work together?" This Administration believes that AID and the private sector can and must work together in order to generate the kind of long-term development in the less developed countries (LDCs) that results in strong and sustained economic growth and human progress.

President Reagan outlined U.S. trade and investment initiatives before the World Affairs Council of Philadelphia last week [October 15]. These initiatives are designed to generate development and growth in the Third World through the force of what the President earlier called "the magic of the marketplace." These initiatives are significant because the less developed countries now, more than ever, understand the the benefits inherent in a strong and viable market economy and the need to expand employment opportunities through a vigorous competitive private sector.

Creation of the Bureau for Private Enterprise in the Agency for International Development, headed by an Assistant Administrator, Elise du Pont, is structural evidence of the new policy direction we have begun to implement. Less emphasis will be placed on transfer of funds, of taxpayer's dollars. Greater emphasis will be placed on the transfer of those things that generate resources—the technology, skills know-how, and capital of the U.S. private sector.

AID's mandate under the Foreign Assistance Act encourages private sector activity. Our new emphasis seeks a partnership of government and the private sector in the total development process—not just involvement at the implementation stage. One important element in AID's policy is to encourage recipient countries to pursue sound economic policies. These self-help measures might include, for example, pursuing realistic exchange rates, increasing aggregate private investment, developing intermediary financial benefits, encouraging fiscally productive taxes, expanding technical training, and the like. I will look to the Bureau for Private Enterprise to formulate and coordinate private sector policy within AID.

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It is our goal to establish a relationship between the U.S. private sector and private sectors in the developing countries. That is the best approach, in our view, for technology transfer, employment generation, and the generation of resources. Economic development in most Third World countries, in fact, hinges on the vigorous interaction between local and foreign private sectors.

Before proceeding further, I would like to stress that while today's presentation focuses totally on AID's involvement with the private sector, AID most certainly has a continued commitment to furthering development by supporting such other key sectors as health, education, and agriculture.

Bureau for Private Enterprise

It is important that I take a few minutes to describe the structure and responsibilities of this new bureau. In order to achieve the objective of facilitating private sector involvement in the developing world, we believed that it was necessary to create a special structure which would not only visibly symbolize our commitment to private enterprise, but which would also, and more importantly, insure that AID developed and implemented new progams and policies.

The bureau consists of two divisions: One houses the two organizations which have played a key role in AID's past involvement with the U.S. private sector, namely, the Office of Business Liaison and the Housing Investment Guarantees Office. Through this division we have the benefit of AID's past involvement with the private sector. The other division consists of two new units, the Office of Investment and Office of Policy and Project Review and Mission Support.

These offices will be staffed by outstanding professionals. We are now in the process of bringing into AID a small team of people who are skilled in such fields as investment and capital market formation. In many ways, they and the programs and policies which they will implement represent a prototype for an AID of the future—an AID which will rely increasingly on leveraging relatively small amounts of public sector funds to attract greater amounts of private sector resources to accomplish goals which in the past have fallen to too great an extent on the shoulders of the taxpayer. Moreover, this bureau will also use more creatively AID project funds to help support projects developed by both the indigenous and U.S. private sectors. The bureau will work closely with private sector liaisons designated in each of the bureaus.

Finally, the Bureau for Private Enterprise will have the lead responsibility for coordinating and relating to the activities of two other agencies which fall within my purview, namely, the Trade and Development Program which reports to me in my capacity as Acting Director of the International Development Cooperation Agency (IDCA) and the Overseas Private Investment Corporation (OPIC) of which I am the Chairman of the Board. The Bureau for Private Enterprise will also be responsible for coordinating with the aid activities of the International Finance Corporation (IFC).

Trade and Development Program

The Trade and Development Program (TDP) is unique and, therefore, requires further elaboration. This program plays a special role in fostering the development of countries while also promoting trade opportunities for the United States. The fiscal year (FY) 1982 budget of the program under the continuing resolution is $4 million. Although this is relatively small, particularly in comparison with similar programs carried out by our major competitors—such as Japan, France, and Germany—the program has a tremendous multiplier effect for U.S. exports.

Essentially, the program seeks to tie U.S. firms into large-scale projects which will be financed by developing countries. Since many of the projects TDP is interested in run into hundreds of millions of dollars, the export potential for the United States is very high. The Trade and Development Program is thus an ideal way in which to foster a mutually beneficial relationship between the United States and the developing world. The following are some of the main approaches which the Reagan Administration plans to take to facilitate U.S. trade through the TDP.

First, TDP funds will be made available at the most critical stage in the planning process of a development project—namely, at the point where U.S. firms are in the final stages of the bidding process for feasibility studies for large-scale projects. For example, we plan to replicate a major success TDP achieved early this year in the Philippines. It was brought to our attention that several countries had offered to conduct, free of charge, a feasibility study for a major steel mill which the Government of the Philippines planned to construct. TDP learned that several U.S. firms were competing for this study and concluded that, given the offer of other nations to conduct the study free, a U.S. firm would most probably not win the bid for the feasibility study. We, in turn, offered a grant of $300,000 to the Government of the Philippines to cost-share on the study if a U.S. firm would be awarded the feasibility study contract. The Philippine Government agreed and U.S. Steel was awarded not only the TDP-financed $300,000 contract but also an additional $4.8 million contract from the Government of the Philippines.

Second, we will concentrate increasingly on the coal and alternate energy sectors. Developing nations desperately need to move away from oil-based energy sources to other sources of energy. Both the U.S. Government and the private sector have devoted huge sums of money to develop new energy technologies with the result that the United States is highly competitive in these areas. TDP is very active in marrying the needs of the developing nations with available U.S. technology and the U.S. firms which can supply it. Moreover, by helping a nation to convert its power base from oil to energy sources such as coal—as TDP is now doing in Jamaica—we also help open export markets for U.S. coal.

Third, we will attempt to use TDP to facilitate access to natural resources of interest to the U.S. Section 661 of the Foreign Assistance Act, which authorizes funds for TDP and specifically encourages the use of TDP funds in this area. In light of our nation's reliance on developing nations for minerals and metals of strategic importance to the United States, we are reviewing with the U.S. Geological Survey, the Bureau of Mines, and other concerned agencies how a portion of TDP's budget might be used to help nations develop the resources we badly need.

Private Sector Approach

I would now like to address our strategy for furthering trade and investment to be carried out by the new Bureau for Private Enterprise. Recognizing that limited AID funds require a targeted approach, the Bureau for Private Enterprise, working with AID's regional bureaus and missions abroad, has selected several countries to receive initial attention—Indonesia, Sri Lanka, Thailand, and Pakistan in Asia; Ivory Coast, Kenya, and Zimbabwe in Africa; Jamaica and Costa Rica in this hemisphere; and Egypt in the Middle East.

Criteria for selection included whether the targeted country had a private sector that was recognized and supported by the host government, whether it was strategically and commercially important to the United States, and whether the United States already had a presence there in the form of an AID mission.

For each country we expect to target a portion of 1982 or 1983 funds for private-sector-related activities; this target will fall within the existing AID overall country budget. As to the specific amounts, we are now in the process of consulting with the House and Senate Appropriations Subcommittees on Foreign Operations, the Senate Foreign Relations Committee, and the House Foreign Affairs Committee. This is not merely ratification but an exchange of views and no numbers can be given until consultation is completed. As to the internal AID mechanism for approving the projects, the project concept will be jointly agreed upon by the AID country mission and the Bureau for Private Enterprise.

On Wednesday, the first of seven reconnaissance missions, headed by an AID official but including business representatives and financial and investment experts, will leave for Indonesia to explore investment and other development opportunities. The team will include George Ferris, Jr., Chairman of the Board, Ferris & Company, Washington, D.C.; Dr. Joel Godhard, a prominent Washington consultant on business strategies; Mr. Ron Katz, an Indonesian-speaking lawyer and Rhodes scholar with a San Francisco law firm; and Mr. R. Jordan, a well-known agribusiness specialist. Their findings will determine exactly what AID may be able to do to stimulate private sector activity in that important nation.

Missions are also scheduled to go to Kenya, Sri Lanka, and Thailand before the end of the year. AID will also be represented on OPIC missions scheduled for Jamaica and Zimbabwe between now and February 1982.

The purpose of the private sector reconnaissance missions will be threefold:

- To determine, one, whether the country has an active and innovative private sector which wishes to expand or diversify investments in job-creating enterprises;
- Two, whether the government has created the climate and infrastructure in terms of policies, procedures, and financial markets to support expanded private sector investments; and
- Three, what are the key opportunities, ideas, or proposals for private sector investments that are developmentally oriented and where AID in some way could facilitate the investment being made. In this latter case, we see a very important role for U.S. private sector involvement, either as a joint partner or as a source of technology, marketing, and managerial skills or other mutually advantageous arrangements.

These missions will be assisted by ad hoc advisers primarily from the private sector, in thinking through both the opportunities and the problems of assisting the targeted countries in private sector development. AID will then suggest to the government and to the AID mission how we, or the U.S. private sector, might be of assistance, either through advisory services in the policy area, capital market development, or in training to facilitate private sector development in that country. AID will also suggest what we perceive as good developmentally oriented private sector opportunities.

The bureau will be working closely with OPIC which has considerable experience in identifying investment opportunities. However, unlike OPIC, we will engage in actually devoting U.S. financial resources now managed by AID to help further U.S. and indigenous private sector involvement in the development process.

AID's subsequent role in developing these opportunities further may be no more than bringing the parties together or financing some preliminary marketing or pre-feasibility studies that would clarify the investment opportunity. I want to stress that AID will take a more active role in assessing the various constraints affecting the success of a particular project and will suggest to the potential investors how they and we might put the various pieces together to make it a good investment. In so doing, we will also examine host country policy affecting the investment and where necessary make appropriate recommendations to the host country so as to facilitate the investment.

We could envision AID in some cases making a financial contribution to particular developmentally oriented projects, either through financial intermediaries that we would support or more directly. If training or small infrastructure investments were particularly important in generating a significant amount of new private sector investment—e.g., processing and marketing agricultural produce—AID might become involved in financing more traditional AID programs to meet that need. We envision some projects, when fully developed, being managed primarily by the private investors but with AID oversight. I believe there are

many cases in the developing world where the U.S. investor, in particular, would feel more comfortable in terms of assessing his risks and making an investment decision if the U.S. Government had an involvement in the project in some way. Depending on the circumstances, AID's role might be as a facilitator. In others, we might be a cofinancer with a private bank, the International Finance Corporation, the World Bank, or other multilateral or bilateral donor agencies.

An illustrative project we might package and finance is as follows: A developing country desires to export packages or processed vegetables, rather than fresh vegetables, to a neighboring high-income country. Productivity per hectare is relatively low by international standards; use of water per irrigated hectare is high. However, agriculture pricing policy provides the right market signals to the farmer, and labor costs in the country, compared to alternative suppliers of similar products, are low. What the country lacks is packaging, processing, and export marketing know-how. The entrepreneur in the developing country has money and managerial talent but lacks knowledge of cost accounting, training of labor in the vegetable processing field, and marketing. This is an opportunity for AID to help put the project together combining new production, marketing, and training technology which the United States can offer with indigenous resources of land, labor, and entrepreneurial talent.

An American partner in this project may offer the technology for higher yield production of vegetables for the export market—seed, irrigation, plant protection—which would be offered to private farmers to produce on contract to the processing plant. A guaranteed quantity and price before planting would reduce the farmer's risk and be an incentive for him to use the new technology offered. The American partner may also make an equity investment in the processing plant, provide cost accounting and training advice and perhaps undertake the marketing of the processed product either as a joint partner or on contract. AID may be involved directly or through an intermediate institution in putting the project together, doing studies, providing credit for the farmers, financing pilot demonstration plots on new technology or more efficient use of water, or take a financial position in the processing plant for the first few years to get the project going and arrange for training.

Let me turn now to the work we are doing with the International Finance Corporation. The Bureau for Private Enterprise is developing a close working relationship with the IFC—the World Bank arm that promotes private enterprise projects in developing nations—where we find a common purpose. The bureau will work with the IFC on capital market development and job-creating investment in the targeted countries. In the action program enunciated by President Reagan last week was this reference:

> We seek to increase cofinancing and other private financing with the multilateral development banks. We want to enhance the international activities which foster private sector debt and equity financing of investments in the developing countries. Its program is increasing in both size and diversity, and the bulk of International Finance Corporation (IFC) projects are privately financed in the developing countries from domestic and external sources.

The bureau will also manage a program to seek out and respond to particularly attractive developmentally oriented private sector opportunities outside the framework of the specific country allocations. Agribusiness, training, and cofinancing with development banks or venture capital organizations and the IFC will be a particular focus.

The bureau will also have the responsibility for managing the International Executive Service Corps' centrally funded project. As I'm sure you are aware, this private and voluntary organization, comprised of retired executives, plays an important role in augmenting AID's manpower. We are honored that they are a part of this team effort. We are also reviewing other centrally funded projects which we may move to the new bureau as appropriate.

In developing its program, the Bureau for Private Enterprise will benefit from the advice of a private sector advisory council, drawn from all segments of the private sector, which is now being formed.

New Approaches

In addition to the work to be undertaken by the new Bureau for Private Enterprise and the ongoing AID projects, we also plan to undertake the following steps:

- Expand AID's Trade and Development Program efforts to conduct feasibility studies and other planning services for development projects. Missions will also expand their funding of studies to identify and encourage private sector development and U.S. exports;
- Establish significant cofinancing programs for development projects with private commercial banks and venture capital firms, both U.S. and LDC based. I would like to stress that in referring to cofinancing, we are not talking about mixed credits for export promotion in the context of the activities of the Export-Import Bank; the matter of mixed credits is now under review by the Administration. Rather, in referring to cofinancing, we are talking in terms of joint ventures to stimulate private investment in productive enterprises. The World Bank and most bilateral aid agencies have also found that cofinancing, whether in the form of parallel or joint financing, is an important means of drawing private debt capital into development projects. By "blending" concessional funds with private credits, two principal benefits are realized: (1) scarce appropriated funds or "stretched" or "leveraged" and (2) private funds are channeled toward developmentally sound projects or transactions. On an ad hoc basis, AID in the past has cofinanced projects with other bilateral and multilateral development agencies. We intend now to develop a program to encourage cofinancing with private capital;
- Expand support of intermediate credit institutions, such as local private development banks, to provide capital to developing country private sector enter-

prises. For example, we are working with the private sector to establish a privately owned development bank in the eastern Caribbean;

- Increase support for managerial and technical training oriented to the private sector;
- Work in close cooperation with appropriate institutions in providing advisory services to developing countries in the following areas: capital market development, investment policy, and industrial and agribusiness policy;
- Stimulate private investment through development of investment opportunities in conjunction with OPIC guarantees and Export-Import Bank credits. We would envision a limited AID role in debt financing, either through the host country or direct lending to U.S. investors against bonds or debentures;
- Help alleviate bottlenecks in the marketing of LDC products. For example, two projects are in formative stages to facilitate interisland marketing in the Caribbean. One involves support to a privately owned regional shipping company which would service the small eastern Caribbean islands. The other is a regional agricultural marketing facility which would trade in fresh produce in the region; and
- Increase investment promotion activities. In this regard, international conventions are planned to link small and medium businesses from the United States with Caribbean businesses for the purpose of launching new joint ventures and transferring technology. A Caribbean project entails project identification activities, linking likely investing partners, and providing followup support to facilitate investment decisions. Also in the Caribbean, we are funding a project development program which will finance resident industrial development advisers. One of the primary functions of these advisers is to identify and appraise business ventures in the small eastern Caribbean islands. The advisers will help identify potential U.S. investors and facilitate business transactions.

Newly Approved AID Projects

Early this year, I undertook a comprehensive inventory of all AID private sector activities. The following is a highlight of those planned or ongoing activities which I believe merit continued support and, in many cases, replication.

In Latin America and the Caribbean, we have developed and funded a number of projects this year which strengthen private sector institutions and support private financial mechanisms.

In Jamaica, after the election of a new government dedicated to the free market under Prime Minister Seaga, the United States was the first nation to offer assistance, providing "bridge" financing to fill the gap pending larger scale support from the International Monetary Fund.

Our long-term objective in Jamaica is to strengthen key sectors of the Jamaican economy in order to stimulate production, exports, and jobs. We and the government have been working closely with the Rockefeller Committee [1] in identifying opportunities for private investment to create jobs and expand foreign exchange earnings. Through the offices of the Rockefeller Committee, and financed by AID, four American private sector advisers screened 408 investment proposals received by the Jamaicans. For those that looked promising, the consultants made contacts, initiated a dialogue, and helped bring interested parties together. We expect new and significant American and Jamaican investments will result from this pioneer effort.

The AID Mission also recently responded to concerns raised by the tourism subcommittee of the Rockefeller Committee about the ability of hotels in Jamaica to respond adequately to an expected good winter tourist season. The International Executive Service Corps and private consultants financed by AID reviewed the situation and made recommendations which may result in the hotels better preparing themselves for this tourist season.

[1] On February 24, 1981, the White House announced the formation of the U.S. Business Committee on Jamaica, chaired by Mr. David Rockefeller, which works with a counterpart Jamaican committee to stimulate and mobilize new investment, trade, and employment in Jamaica.

In Costa Rica, we have made a $10 million loan to the privately owned Agro-Industrial and Export Bank of Costa Rica (BANEX) to promote nontraditional exports from that country. Credit, banking, and marketing services are provided to help Costa Rican producers sell their products abroad. The AID loan is structured to leverage an equivalent amount of private commercial bank lending to BANEX.

In Central America, a recent $6 million loan to the Latin American Agribusiness Development Corporation (LAAD) will allow that organization to finance some 45 agribusiness projects expected to create 10,000 jobs in Central America. This program also encourages a cofinancing arrangement whereby LAAD will match the AID loan with $6 million in private bank borrowings. With the AID and private bank loans and LAAD's own resources, more than $29 million will be available for agribusiness projects in Central America. I should note that we are now considering replicating the LAAD approach in Africa.

In the Near East, a major development, which I personally approved, is the establishment of a new $25 million trade financing facility to enable U.S. companies who are low bidders to compete more favorably on international tenders where better terms of financing are necessary.

In closing, let me stress our deep appreciation for the interest you and your subcommittee have shown in our program. Today's hearing occurs on the eve of the Cancun conference where President Reagan will again stress the vital role of private enterprise in the development process. I will be joining our delegation to the summit and I can assure you that we will very much keep in mind the thoughts and advice you will have offered today on the interaction of aid and trade.

MR. HORMATS

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Noninvestment Assistance

A number of the businessmen whom we have contacted have spoken about the advantages of increased private sector exchange programs, providing expertise through instruction here and abroad. This could take several forms:

Managers and technicians in key economic sectors could receive on-the-job instruction in the United States. For example, in the important agricultural sector, a leading agricultural university in a large west African country already sends farm managers to a cooperating American midwestern university which assigns the "students" individually to work on farms for specified training periods of several months. The trainee returns home mindful not only of the practical instruction received but of the American products to which he was exposed—the tractor, the air conditioner, the nutritive supplements added to feed mixes. Similar programs could be established for other interested countries and in other key development sectors.

Another approach suggested by a number of businessmen is assistance by U.S. private sector experts in critical phases of overseas projects. For example, an experienced manager or engineer serving as a consultant could make a significant contribution during the startup phase of a manufacturjng plant.

This type of ad hoc, "hands-on" approach is also used successfully by the International Executive Service Corps. There seems to be potential for greater private sector contributions along these lines, both on a remunerative and a voluntary basis.

There are other approaches to the transfer of skills and know-how; many are already in use. Overseas banches can conduct onsite workshops and training programs at their plants and repair centers, open to nonemployees as well as employees. They might support local scientific and educational institutions.

Visiting American executives can serve as guest speakers at foreign universities and management institutes as well as at business forums. People abroad wish to learn about American business techniques. The American businessman is still regarded, perhaps increasingly, as having the know-how to vitalize an economy. The power of example can have significant impact. The reverse side of this approach is for the private sector to sponsor attendance of developing country personnel at international symposia and fairs.

Government Support for Business

I have mentioned in passing some areas in which the U.S. Government can help the private sector in its involvement in developing countries. What else can we do to assist? Let me state again my firm belief that government should not attempt to lead or to dominate but rather to support and to facilitate where needed. Excellent organizations, mechanisms, and systems already exist, outside and inside government, which can help U.S. business to do more along the lines I have suggested above. The State Department can encourage and, at times, act as a catalyst by linking ideas, persons, and institutions that can help make these ideas work. In the Department we plan to continue our dialogue with business leaders and others from the private sector so that we can understand their needs at firsthand and so that they can share our thoughts.

The Department of State and our ambassadors will also be playing a more active role in support of U.S. business efforts. Specifically, we will do more to assist American business to obtain a larger share of these markets and support them to insure fair treatment of their investments and a fuller share of the licensing, consulting, and other service contracts so intrinsic to the development process. We are determined that the State Department, in full partnership with the U.S. Trade Representative and the Commerce Department, should form part of a "business facilitation triad" which will work for a more open international trading and investment system in which U.S. companies can compete on fair and attractive terms for participation in LDC markets and development.

Secretary Haig has instructed our ambassadors to assign very high priority to supporting American business abroad and to encouraging LDC governments to develop a more hospitable environment for U.S. business and for private enterprise in general. He was very clear in his recent instruction to all ambassadors:

> I look to you to involve yourself personally in leading the U.S. Government commercial effort in your country. [There can be no] half-hearted, unsustained efforts or lip service. It must be a conviction and a major purpose in your ambassadorial stewardship.

In my Bureau for Economic and Business Affairs, we have strengthened the Office of Commercial Affairs as the central point for support for the business community. This office will aid in export-promotion efforts, the removal of export disincentives, and in helping solve problems for business abroad by cutting through the bureaucratic tangle which frequently prevents timely solutions.

The Trade Reorganization Act of 1979 established the new Foreign Commercial Service, administered by the Commerce Department, to handle export promotion efforts with our major trading partners. The State Department is working in full cooperation with the new service to insure its success, in addition to urging ambassadors and other senior Embassy officers to do so. The State Department is directly involved in the commercial business, particularly in the developing world. We retain direct responsibility for commercial work in 75 countries which together purchased over $16 billion in U.S. merchandise and agricultural exports in 1980. It is important to support U.S. export efforts in these countries in the most effective way possible, and we plan to do so in ways that will benefit both economic growth in our own country and in the developing nations.

Just as important, however, is a unique contribution that the State Department at home can make in support of American business in the developing nations. Frequently senior executives of major U.S. multinational corporations have less of a need for

specific commercial support than for background and analysis on which to base their strategic planning and risk assessment. At the State Department there exists a broad range of essential political and economic information and judgment which can be of considerable value to American companies making decisions about foreign operations. The Department will be fully responsive in sharing this information and perspective appropriately with business.

In closing, I would like to note a number of specific actions which have already been implemented by the Reagan Administration to reduce export disincentives:

- A previous policy regarding arms sales has been changed; our Embassies can now provide the same courtesies and commercial services to firms selling defense equipment as they do for other businesses.
- The Export-Import Bank restriction on lending to Chile was lifted early in the year.
- Licenses for export of five civilian Boeing aircraft to Iraq, held up for more than a year, were issued in May.

We have set in motion a vigorous policy of support for the U.S. private sector at the State Department and our Embassies—a policy which has as its central objective a more active and responsive role in encouraging and assisting American business to play the essential role that we know it can, and can benefit from, in the developing world.■

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